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No. 93-714

In The
Supreme Court of the United States
October Term, 1993

U.S. Bancorp Mortgage Company,
Petitioner,
v.
Bonner Mall Partnership,
Respondent.

Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

BRIEF IN OPPOSITION

Barbara Buchanan
John Ford Elsaesser, Jr.
Counsel of Record
Elsaesser Jarzabek & Buchanan, Chtd.
Third & Lake Streets
P.O. Box 1049
Sandpoint, ID 83864
(208) 263-8517
Counsel for Respondent

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
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STATEMENT OF THE CASE

I. NATURE OF THE CASE

This case arises out of a Chapter 11 bankruptcy proceeding which is currently pending before the United States Bankruptcy Court for the District of Idaho. U.S. Bancorp, the major secured creditor, is seeking to have the Chapter 11 proceeding dismissed, or in the alternative, to be granted relief from stay, on the grounds that the debtor's proposed Plan of Reorganization violates the absolute priority rule and is unconfirmable as a matter of law.

The sole issue on appeal is whether the enactment of the 1978 Bankruptcy Code revoked the new value exception to the absolute priority rule recognized under the Bankruptcy Act. The bankruptcy court held that the new value exception did not survive enactment of the Code and granted U.S. Bancorp's motion for relief from stay. The Federal District Court reversed and the Ninth Circuit affirmed the district court.

II. STATEMENT OF FACTS

The Petitioner's factual and procedural history is sparse and incomplete. Respondent is providing the following statement in an attempt to present the case in a full and complete perspective. The Respondent in this case is the Bonner Mall Partnership, an Idaho general partnership comprised of six partners. Lloyd Andrews, an individual, owns a 25% interest in the partnership. Five individual trusts comprise the remaining partners, with each trust holding a 15% interest. H.F. Magnuson is the trustee for each of the five trusts.

The Partnership was formed in 1986 for the specific purpose of acquiring the Bonner Mall, a retail shopping center located on 16 acres of land one mile north of Sandpoint, Idaho in the small community of Ponderay.

The Bonner Mall was constructed in 1984 and 1985 by Northtown Investments, an Idaho general partnership comprised of seven individuals and their spouses. Lloyd Andrews was one of the seven Northtown partners. Neither the trusts nor H.F. Magnuson, the trustee, held any interest in Northtown Investments. On February 17, 1985,

First National Bank of North Idaho (FNB) loaned Northtown Investments $6.2 million secured by a note and deed of trust on the Bonner Mall. In 1986, FNB sold the loan to Petitioner U.S. Bancorp Mortgage Company (U.S. Bancorp).

The Partnership purchased the mall, including the mall buildings and the surrounding real estate from Northtown Investments on October 31, 1986. The Partnership did not, however, assume the U.S. Bancorp debt and neither the Partnership nor H.F. Magnuson is personally liable for the $6.2 million debt. The Partnership has continuously owned and operated the Bonner Mall since October 31, 1986.

The Partnership made the purchase with the full expectation that the rental income from the mall's tenants would be sufficient to service the debt. Unfortunately, that did not prove to be the case. The Partnership was never able to establish and maintain a stable tenant base sufficient to cover the operating expenses and service the indebtedness.

On July 10, 1990, U.S. Bancorp caused a notice of default and a notice of trustee's sale to be filed against the Bonner Mall Partnership noticing the property up for a trustee's sale on November 20, 1990. That same day, U.S. Bancorp sent letters to all of the tenants in the Bonner Mall demanding that all rents be paid directly to U.S. Bancorp. Since that date, U.S. Bancorp has been receiving the rental income from the mall.

The sole basis for the notice of default and the notice of trustee's sale was the fact that the Partnership was delinquent on its real property taxes to Bonner County.

The notice of default cited the Partnership's failure to "pay at least ten days before delinquency all taxes and assessments" effecting the Bonner Mall property. The Partnership was current on all its obligations to U.S. Bancorp in July of 1990, when the Notice of Default was filed.

Between July 1990 and March of 1991, the Partnership was involved in extensive negotiations with both Bonner County and U.S. Bancorp in an effort to solve the tax assessment problem and, even more significantly, to restructure the $6.2 million indebtedness. It had become evident to all parties that the Bonner Mall could not service the $6.2 million indebtedness and would not be able to do so in the foreseeable future. The negotiations between U.S. Bancorp and the Partnership centered upon agreeing to a realistic value for the Bonner Mall and the possibility of writing the $6.2 million debt down to an amount which would more accurately reflect that value. The parties were unable to reach a resolution, and after three postponements, the trustee's sale was rescheduled for March 14, 1991. In order to prevent a non-judicial foreclosure sale on the Bonner Mall, the Partnership filed for relief under Chapter 11 of the United States Bankruptcy Code on March 13, 1991.

The Bonner Mall is currently being managed by R. W. Robideaux & Company, a Spokane based property management firm. U.S. Bancorp continues to receive all of the rental income from the mall and continues to pay the monthly operating expenses pursuant to a stipulation for adequate protection.

The Debtor is proposing through its First Amended Plan of Reorganization to transfer all of the assets of the estate from the existing partnership to a new corporation, Bonner Properties, Inc., the reorganized debtor. In exchange for their claims, the unsecured creditors would receive 300,000 shares of Class A preferred stock in the new corporation. The shares would have a par value of $1.00 and would be convertible at any time after the payment of U.S. Bancorp's secured claim into 15% of the then outstanding shares of common stock. In the event of a liquidation, the preferred stock is given a liquidation preference, ahead of the common stock, equal to its par value – $300,000.

In order to fund the reorganization, the Plan proposes for the existing trusts and Lloyd Andrews, to make a capital contribution of $200,000 plus additional amounts needed to complete the court authorized repairs to the mall and to cover any shortfall in operating expenses for a 32 month period following confirmation of the Plan. Additionally, the trustee for the five trusts, H. F. Magnuson, proposes to grant to the reorganized debtor a collateral trust mortgage on 4500 acres of real property with a fair market value of approximately $4.5 million and an equity value of approximately $2 million. In exchange for a capital contribution of $300,000 plus in cash and approximately two million dollars in real property, the existing partners would receive 2 million shares of common stock in the corporation.

The Plan proposes to pay U.S. Bancorp's $3.2 million secured claim in full 32 months after the effective date of the Plan. In the interim, U.S. Bancorp would receive monthly interest payments at a rate to be set by the court.

The Plan proposes to pay the other secured creditors the allowed value of their secured claim over various time periods with interest.

III. COURSE OF PROCEEDINGS

Bonner Mall Partnership filed its petition for relief under Chapter 11 of the United States Bankruptcy Code on March 13, 1991. Fourteen days later, before Debtor's bankruptcy schedules and statement of affairs had been completed and filed, U.S. Bancorp filed a motion to dismiss the Chapter 11. The Debtor filed its memorandum in opposition to the motion to dismiss on April 16, 1991. On April 23, 1991, before the motion to dismiss could be heard, U.S. Bancorp filed a Motion to Modify Stay seeking relief from the automatic stay under 11 U.S.C. § 362(a) to foreclose its security interest in the Bonner Mall. Both motions came on for hearing before the Honorable Alfred C. Hagan, U.S. Bankruptcy Judge for the District of Idaho on June 13, 1991, and again on July 2, 1991.

On August 23, 1991, Judge Hagan issued his first Memorandum of Decision. That decision valued U.S. Bancorp's collateral, the Bonner Mall, at $3.2 million and provisionally denied both the motion for relief from stay and the motion to dismiss. The court gave the Debtor thirty (30) days to file a Chapter 11 plan and disclosure statement which were not subject to rejection as a matter of law. With regard to the possibility of confirming a plan of reorganization given the strictures of the absolute priority rule, the court stated as follows:

> An exception to the absolute priority rule exists in the form of "infusion of new capital", commonly called the *Los Angeles Lumber* exception. Simply stated, the debtor can retain an interest in the chapter 11 estate ahead of creditors to the extent new capital is put into the estate by the debtor.

(Judge Hagan's initial decision is appended to the Petition for Writ of Certiorari at A118-A129. The above referenced quote is found at A124.)

Debtor filed its Plan of Reorganization and Disclosure Statement on September 23, 1991. On October 4, 1991, U.S. Bancorp renewed its motions for relief from stay and dismissal asserting that the Plan and disclosure statement were unconfirmable as a matter of law.

On October 31, 1991, Debtor filed its First Amended Plan of Reorganization and First Amended Disclosure Statement. The hearing on the renewed motions and on the first amended disclosure statement took place on November 13, 1991. Both counsel for the Debtor and counsel for U.S. Bancorp submitted written memorandum in support of their positions on the renewed motions. Pursuant to a stipulation by the parties that the issue for determination was purely a legal issue, the court heard no testimony and took no evidence at the November 13, 1991, hearing. Counsel for both sides presented oral argument and the court took the motions under advisement.

On December 6, 1991, the bankruptcy court issued its second memorandum of decision. The decision granted U.S. Bancorp's motion for relief from stay to foreclose its security interest in the Bonner Mall. In so doing, the court reversed its earlier ruling that a debtor may retain an

interest in a Chapter 11 estate ahead of creditors to the extent the debtor contributes new value, citing the Fifth Circuit Court of Appeals' decision in *Phoenix Mutual Life Ins. Co. v. Greystone III Venture*, 948 F.2d 134 (5th Cir. 1991), *withdrawn in relevant part* (*per curiam*) (Jones, J. dissenting from withdrawal), *cert. denied*, ___ U.S. ___, 113 S. Ct. 72, 121 L. Ed. 2d 37 (1992).

> Since the time of the previous decision on this subject in this case, the Fifth Circuit Court of Appeals in *Phoenix Mutual Life Ins. Co. v. Greystone III Joint Venture* has held the new value exception is not available under the Bankruptcy Code. The opinion holds the 1978 Bankruptcy Code did not provide for new value exception to the absolute priority rule. The Court discussed the effect of allowing the exception under the present Code and found that to do so would allow "old equity" to retain control of, and run, the reorganized debtor while impairing the rights of dissenting secured creditors and that such treatment is not authorized and should not be authorized under the present statutes.

The Bankruptcy Court's second opinion is reported at 91 IBCR 187 (Idaho 1991) and reprinted at Appendix A1-A3.

On December 11, 1991, Debtor filed its Notice of Appeal from the December 6, 1991, Memorandum of Decision and Order. On December 9, 1991, Debtor filed a Motion for Stay Pending Appeal. The motion was heard before the bankruptcy court on January 6, 1992. On January 14, 1992, Judge Hagan entered an order granting stay pending appeal.

The matter was argued before the district court, the Honorable Harold L. Ryan presiding, on July 10, 1992. On

July 15, 1992, Judge Ryan issued his Opinion and Order. The district court found that the single issue before it on appeal was "whether the judicially created new value exception to the absolute priority rule survived the enactment of the 1978 Bankruptcy Code." (The District Court's Opinion and Order is reprinted at A88-A117 of the Petition for Writ of Certiorari. The above referenced quote is found at A98.) The court, focusing on the guidelines for statutory construction recently enunciated by this court in *Dewsnup v. Timm*, 502 U.S. ___, 112 S. Ct. 773, 116 L. Ed. 2d 903 (1992) and on the underlying policy of Chapter 11 of the Bankruptcy Code, reversed the bankruptcy court and held that it did. *See* Petition at A88-A117.

U.S. Bancorp timely appealed to the Ninth Circuit. Oral argument to the Circuit Panel took place on March 2, 1993. On August 4, 1993, the Ninth Circuit issued its decision affirming the judgment of the district court and remanding the case to the bankruptcy court for further proceedings. (The Ninth Circuit's opinion is appended to the Petition for Writ of Certiorari at A1-A84.) U.S. Bancorp is before this Court seeking a writ of certiorari to review the Ninth Circuit decision.

SUMMARY OF THE ARGUMENT

This Court should only grant a petition for writ of certiorari when a United States court of appeals has rendered a decision in conflict with the decision of another United States court of appeals on the same matter; has decided a federal question in a way that conflicts with

applicable decisions of this Court; or when the case involves an important question of federal law which has not been, but should be, settled by this Court. Rule 10, Rules of the Supreme Court (Jan. 1, 1990).

Despite U.S. Bancorp's assertion to the contrary, the Ninth Circuit's decision in *Bonner Mall Partnership v. U.S. Bancorp Mortgage Co.*, is not in conflict with any other decision of a United States court of appeal; nor is it in conflict with applicable decisions of this Court. The only circuit court decision directly in conflict with the Bonner Mall opinion was the Fifth Circuit's original decision in *Phoenix Mutual Life Ins. Co. v. Greystone III Joint Venture (In Re: Greystone III Joint Venture)*, 948 F.2d 134, Part IV (5th Cir. 1991). The Fifth Circuit withdrew the portion of its decision rejecting the new value exception four months later, in response to this Court's decision in *Dewsnup v. Timm*, 502 U.S. ___, 112 S. Ct. 773, 116 L. Ed. 2d 903 (1992). *See* 995 F.2d 1274, 1284-85.

The *Bonner Mall* decision is fully consistent with recent decisions of this Court. In *Dewsnup*, 502 U.S. at ___, 112 S. Ct. at 779, this Court held that where the text of the Bankruptcy Code does not unambiguously abrogate pre-Code practice, courts should presume that Congress intended pre-Code practice to continue unless the legislative history dictates a contrary result. As the Ninth Circuit Panel recognized, the legislative history of the Bankruptcy Code supports the continued existence of the new value doctrine. *See* Petition, at A57-A58. The judgment of the Ninth Circuit in the instant case is in accord with this Court's decisions interpreting the Bankruptcy Code.

Respondent concedes that the new value exception involves an important issue of federal law, however, Respondent does not concede that the issue is ripe for review by this Court. While federal district courts and bankruptcy courts nationwide have divided on the issue, the majority of courts that have considered the question have held that the new value exception survived enactment of the Bankruptcy Code. *See* Petition, at A31-A32.

The Ninth Circuit's decision is in accord with the majority position; is not in conflict with any other circuit level authority; and follows the most recent decisions of this Court interpreting the Bankruptcy Code. The decision should not be reviewed.

ARGUMENT

I. The issue of the survival of the new value exception is not ripe for review by this Court.

The existence of the new value doctrine is an important question of federal law which has been largely settled by the Ninth Circuit's decision in the *Bonner Mall* case. U.S. Bancorp suggests in its petition that this Court should accept certiorari on public policy considerations:

> The new value exception would profoundly diminish creditors' control over the reorganization process.
>
> . . .
>
> This issue occurs frequently in bankruptcy cases and is of considerable importance to the lending community. The issue raises significant public

> policy considerations in that the existence of the new value exception adds tremendous uncertainty to credit markets. The new value exception in essence allows the bankruptcy court to write new loans for lenders on terms they never envisioned and which, in their business judgment, they would not consider prudent. *See* Petition for Writ of Certiorari, at 8-9.

Respondent asserts that there are important public policy considerations which weigh in favor of recognizing the continuing viability of the new value exception. The new value exception was created by courts in response to the recognition that inflexible application of the absolute priority rule would, in many instances, subvert the very process of reorganization which the rule was intended to promote. *In re Tallahassee Associates*, 132 Bankr. 712, 717 (W.D. Penn. 1991).

If this Court were to accept certiorari and interpret 11 U.S.C. § 1129(b) as suggested by the Petitioner, Chapter 11 reorganization would be foreclosed as a realistic option for many business entities. Without the exception, the only option available for owners who want to preserve their ownership interest and continue their business is to pay dissenting unsecured creditors in full. In many cases that is an impossibility and, as a practical matter, there would be little incentive in most cases for business owners to undergo the cost and effort of a Chapter 11 reorganization under such constraints. *In re Pullman Construct. Indus., Inc.*, 107 Bankr. 909, 947, (N.D. Ill. 1989).

The purpose of Chapter 11 is to permit and to foster the successful rehabilitation of debtors. *NLRB v. Bildisco &*

Bildisco, 465 U.S. 513 (1984). The interpretation of § 1129(b) urged by Petitioner in this case would not promote the underlying purpose of Chapter 11. To the contrary, its adoption would significantly limit the use of Chapter 11. Both the district court and the Ninth Circuit Panel recognized this fact in their decisions. "In addition, the language of the Code must be read in light of the underlying bankruptcy principles. '[C]ontinued application of the new value exception comports with the policy underlying Chapter 11 reorganizations. The purpose of Chapter 11 is to successfully rehabilitate the debtor.' " *See* Opinion and Order of the District Court, Petition at A115-A116 (citations omitted).

> Chapter 11 has two major objectives 1) to permit successful rehabilitation of debtors (citation omitted); and 2) to maximize the value of the estate (citation omitted). The new value exception, properly applied, serves both goals. By permitting prior stockholders to contribute new money in exchange for participation in the reorganized company, the debtor is given an additional source of capital. The new contribution increases the amount available for the estate to use both in its reorganization and in funding the plan and paying creditors. Without the inducement of participation in the reorganized debtor, the new money may be unavailable. (citation omitted). All parties involved, including the creditors, benefit from an increase in the assets of the estate. Judgment of the Ninth Circuit, Petition at A71-A72.

II. The Decision below is in accord with applicable decisions of this Court.

The Petitioner asserts that the court of appeals' decision conflicts both with this Court's decision in *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988) and the line of this Court's decisions interpreting the Bankruptcy Code. The *Ahlers* case is the only Supreme Court case which has interpreted 11 U.S.C. § 1129(b). Contrary to the Petitioner's assertion, the *Ahlers* decision cannot be read as a comment, one way or the other, on the continued vitality of the new value exception.

> We need not reach this question to resolve the instant dispute. As we discuss *infra*, at 204-206, 99 L. Ed. 2d, at 178-179, we think it clear that even if the *Los Angeles Lumber* exception to the absolute priority rule has survived enactment of the Bankruptcy Code, this exception does not encompass respondents' promise to contribute their "labor, experience, and expertise" to the reorganized enterprise.
>
> Thus, our decision today should not be taken as any comment on the continuing vitality of the *Los Angeles Lumber* exception – a question which has divided the lower courts since the passage of the Code in 1978.

485 U.S. at 203, n.3.

The Petitioner's assertion that the court of appeals' decision in the *Bonner Mall* conflicts with this Court's approach to resolution of conflicts between pro-Code judicially-created rules and the Bankruptcy Code is also in error. The Petitioner's statement that the court of appeals' decision conflicts with *Dewsnup* is especially

incongruous in light of the Fifth Circuit's decision in *Greystone*. The original Fifth Circuit opinion specifically held that the new value exception to the absolute priority rule did not survive the enactment of the Bankruptcy Code. *See* 948 F.2d 134, 142-44 (5th Cir. 1991). After this Court released its decision in *Dewsnup*, the Fifth Circuit withdrew that portion of its opinion addressing the new value exception. *See* 955 F.2d 1274, 1284-85.

The absolute priority rule has been recognized by this Court since before the turn of the century. By 1913, the absolute priority rule was a "fixed principle." *Northern Pacific Railway Co. v. Boyd*, 228 U.S. 482 (1913). Another fixed principle prior to the enactment of the Bankruptcy Act was that capital is an essential ingredient for a successful reorganization and that it may be impossible to obtain unless the existing equity holders are permitted to contribute and retain an interest in the reorganized debtor. *Kansas City Terminal Ry. v. Central Union Trust Co.*, 271 U.S. 445, 455 (1926).

Before the Supreme Court could reach a decision in *Case v. Los Angeles Lumber*, it was first called upon to decide whether Congress had adopted the absolute priority rule as part of the Bankruptcy Act. The statute merely required that a plan be "fair and equitable" as a condition of confirmation. It did not mention the absolute priority rule. The Court determined that the term "fair and equitable" had acquired a fixed meaning within the law and applied the rule of statutory construction that where words are employed in an act which had at the time a well known meaning in the law, they are used in that sense unless the context requires the contrary. *Case v. Los Angeles Lumber Co.*, 308 U.S. 106, 115 (1939). This Court

thus concluded that even though the Bankruptcy Act did not mention either the absolute priority rule or any exception to the rule, Congress had intended to incorporate both the rule and the exception when it adopted the Bankruptcy Act. *Id.* at 117.

The same reasoning applies to the 1978 Bankruptcy Code. When Congress used the words "fair and equitable" in section 1129 of the Code, it was with the express knowledge that this Court had held in 1939 that the phrase "fair and equitable" was a term of art with an established meaning which included both the absolute priority rule and the new value exception.

Congressional silence regarding codification of the new value exception cannot be interpreted as eliminating a substantial, judicially-created exception to the absolute priority rule. *In re: SLC Limited V*, 22 Bankr. Ct. Dec. 1081 (D. Utah 1992).

> The normal rule of statutory construction is that if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific. (citation omitted) The Court has followed this rule with particular care in construing the scope of bankruptcy codifications.

Midlantic National Bank v. New Jersey Dept. of Environmental Protection, 474 U.S. 494, 501 (1986).

The most recent Supreme Court authority on this issue reaffirms the significance of bankruptcy practice prior to the passage of the Code and underscores this Court's unwillingness to interpret the Bankruptcy Code in a manner contrary to pre-Code practice. *Dewsnup v. Timm*, 502 U.S. ___, 112 S. Ct. 773, 116 L. Ed. 2d 903.

The issue before the Court in *Dewsnup* was whether a debtor pursuant to 11 U.S.C. § 506(d) could strip down a creditor's lien on real property to the judicially determined value of the collateral. This Court focused on pre-Code law to hold that § 506(d) does not allow a debtor to strip down a lien on real property. *Dewsnup* stands for the proposition that terms used in the Bankruptcy Code must be construed in a manner that is consistent with pre-Code practice.

> When Congress amends the bankruptcy laws, it does not write "on a clean slate" (citation omitted). Furthermore this Court has been reluctant to accept arguments that would interpret the Code however vague the particular language under consideration might be, to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history.

502 U.S. at ___, 112 S. Ct. at 779 (citations omitted). The court of appeals' decision in the *Bonner Mall* is fully consistent with *Dewsnup* and with long standing principles of statutory construction.

III. The Decision below is not in direct conflict with any other circuit level authority.

Both the eighth and the sixth circuits have held that the new value doctrine exists. *In re Anderson*, 913 F.2d 530 (8th Cir. 1990) (affirmed district court's conclusion that

debtors failed to meet their burden of showing a contribution that could be recognized under the new value exception.); *In re U.S. Truck Co.*, 800 F.2d 581 (6th Cir. 1986) (assumed the survival of the new value exception). The Seventh Circuit, while expressing approval for the rule in *dicta*, recently declined for the third time to rule on the continued viability of the doctrine.

> The debtors ask us to hold that the new value exception remains viable under the 1978 Code, while Farm Credit asks us to hold that it has vanished. We stop short of both parties' requests, as we did in *Kahm & Nate's Shoes and Stegall*, and as the Supreme Court did in *Ahlers*. We conclude instead that, assuming the new value retains its vitality, the Debtors' proposed contribution fails to meet its requirements. We therefore again reserve the issue the new value exception's continued viability for another day.

Snyder v. Farm Credit Bank of St. Louis, 967 F.2d 1126, 1130-31 (7th Cir. 1992).

The Seventh Circuit did recognize that the majority view favors the viability of the exception and expressed its general agreement with that view, however. *Id.* at 1129.

> Opponents of the continued vitality of the new value exception have pointed to the language of the 1978 Code, in particular the codification of the absolute priority rule without any explicit exception for new value. (citations omitted) But their approach seems to slight a settled cannon of interpretation: "If Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific. The Court has followed this rule with particular care in construing the scope of bankruptcy codifications." (citations omitted) This year the Court further explained: "When Congress amends the bankruptcy laws, it does not write 'on a clean slate.' Furthermore, this Court has been reluctant to accept arguments that would interpret the Code, however vague the particular language under consideration might be, to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history. (citations omitted).

> There is nothing in either the text or the legislative history of 1129(b) that can be said to demonstrate clear intent to modify seventy-five years of judicial construction of the absolute priority doctrine or its new value exception. The mere fact that Congress did not separately codify the exception does not establish its elimination for Congress is presumed to have been aware of the courts' interpretation of the contours of the absolute priority rule when it codified the rule. (citations omitted).

Id. at 1129.

The Fifth Circuit is the only circuit court which has issued a ruling holding that the exception does not exist. *In re Greystone III Joint Venture*, 948 F.2d 134 (5th Cir. 1991). On rehearing, however, the panel withdrew the portion of the majority opinion which dealt with the new value exception. *See* 995 F.2d 1274, 1284-85 (5th Cir. 1992). The Fifth Circuit's self-reversal on the new value exception appears to have been based, at least in part, on the recent Supreme Court decision in *Dewsnup v. Timm*, 502 U.S. ___, 112 S. Ct. 773, 116 L. Ed. 2d 903 (1992), in which this Court held that Bankruptcy Code provisions must be

interpreted in light of pre-Code practices. *See Greystone*, 995 F.2d at 1284-85 (Jones, J., dissenting from withdrawal); *Snyder v. Farm Credit Bank of St. Louis*, 967 F.2d 1126, 1129.

The majority of the lower courts which have addressed the issue have also held that the doctrine retains its viability under the 1978 Code. *See, e.g., In re Tallahassee Associates, L.P.*, 132 Bankr. 712, 717 (W.D. Penn. 1991) (citations omitted); *Snyder v. Farm Credit Bank of St. Louis*, 99 Bankr. 885, 888 (C.D. Ill. 1989). There is no conflict between the circuits and thus no need for Supreme Court review.

CONCLUSION

This Court should only grant a petition for writ of certiorari when a United States court of appeals has rendered a decision in conflict with the decision of another United States court of appeals on the same matter; has decided a federal question in a way that conflicts with applicable decisions of this Court; or when the case involves an important question of federal law which has not been, but should be, settled by this Court. Rule 10, Rules of the Supreme Court (Jan. 1, 1990).

The Ninth Circuit's decision is in accord with the majority position; is not in conflict with any other circuit level authority; and follows the most recent decisions of

this Court interpreting the Bankruptcy Code. The decision should not be reviewed.

Respectfully submitted,

BARBARA BUCHANAN
JOHN FORD ELSAESSER, JR.
ELSAESSER, JARZABEK &
BUCHANAN, CHTD.
123 S. Third Street
P.O. Box 1049
Sandpoint, ID 83864
(208) 263-8517

Counsel for Respondent

APPENDIX

Vol. 91, No. 84
IN THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF IDAHO
Cite as: 91 IBCR 187

In re:
BONNER MALL PARTNERSHIP,
Debtor.

Case No. 91-00801-11
MEMORANDUM OF DECISION

Ford Elsaesser and Barbara Buchanan, ELSAESSER, JARZABEK, BUCHANAN & DRESSEL, Sandpoint, Idaho, and Jerome Shulkin, SHULKIN, HUTTON & BUCKNELL, Seattle, Washington, for debtor.

Dale G. Higer and Thomas R. Linville, EBERLE, BERLIN, KADING, TURNBOW & McKLVEEN, Boise, Idaho, for U.S. Bancorp Mortgage Company.

HONORABLE ALFRED C. HAGAN, U.S. BANKRUPTCY JUDGE

U.S. Bancorp has moved for relief from the Section 362 automatic stay and to dismiss the debtor's chapter 11 petition.

After a hearing, it appears the granting of either motion depends on the ability of the debtor to formulate and obtain confirmation of a plan of reorganization under the statutory provisions of Chapter 11 of Title 11 of the United States Code. If it is apparent the debtor cannot obtain confirmation of a chapter 11 plan in accordance

with its purposes of reorganization, stay relief is appropriate under the *Timbers* decision of the United States Supreme Court[1] and dismissal would be appropriate under the provisions of 11 U.S.C. § 1112(1) or (2).

Considering the motion for stay relief, as it is possible for the Bank to be adequately protected pending the filing of a chapter 11 plan through adequate protection payments and the Bank is presently collecting the rents, since the property involved is the property sought to be reorganized, and since no other ground for cause for stay relief has been shown by the Bank to exist under the provisions of Section 362(d)(1), the issues are dependent on the prospective ability of the debtor to formulate a plan.

The dilemma the debtor faces is the requirement, recognized by the *Timbers* decision, a chapter 11 debtor must have a realistic prospect of an effective reorganization.

> Section 362(d)(2) also belies petitioner's contention that undersecured creditors will face inordinate and extortionate delay if they are denied compensation for interest lost during the stay as part of "adequate protection" under § 362(d)(1). Once the movant under § 362(d)(2) establishes that he is an undersecured creditor, it is the burden of the *debtor* to establish that the collateral at issue is "necessary to an effective reorganization". See § 362(g). What this requires is not merely a showing that if there is conceivably to be an effective reorganization, this property will be needed for it; but that the property is essential for an effective reorganization *that is in prospect*. This means, as many lower courts, including the en banc court in this case, have properly said, that there must be "a reasonable possibility of a successful reorganization within a reasonable time." 808 F.2d, at 370-371, and nn. 12-13, and cases cited therein. The cases are numerous in which § 362(d)(2) relief has been provided within less than a year from the filing of the bankruptcy petition. And while the bankruptcy courts demand less detailed showings during the four months in which the debtor is given the exclusive right to put together a plan, see 11 U.S.C. §§ 1121(b), (c)(2), even within that period lack of any realistic prospect of effective reorganization will require § 362(d)(2) relief. (Footnotes omitted)[2]

Under the provisions of 11 U.S.C. § 1129(b), since the Bank is an undersecured creditor, the Bank would most likely be in a position to block acceptance of any proposed plan of reorganization which contains an impairment of its secured claim.[3] The Bank is definitely undersecured. The property sought to be reorganized, the Bonner Mall, is valued by the Bank at $3.8 million and by the debtor at $2.4 million. The Bank's claim is $6.3 million. The debtor's scheme of reorganization depends upon the reduction of the Bank's claim to the value of the security. It is thus difficult to envision how the debtor will be able to obtain confirmation of a plan under the chapter 11 statutory requirements, nevertheless, the debtor's contentions will be considered.

Counsel for the debtor contends other unsecured creditors exist who would affect the plan acceptance provisions of 11 U.S.C. § 1126(c), including the claims of the individual partners who comprise the debtor limited partnership. However, the debtor's schedules indicate the

only other unsecured claims are $62,178.00 owing to the Magnuson Children Trusts and a priority tax claim of Bonner County of $195,500.00.

Counsel for the debtor further contends it may be possible to obtain confirmation of a plan by providing for separate classes of unsecured debt. Yet, under the provisions of 11 U.S.C. § 1129(a)(8), each class of impaired claims or interests must accept the plan. Otherwise, the provisions of Section 1129(b) apply and the debtor would be required to pay the unsecured claim of the Bank in full under the absolute priority rule provisions of Section 1129(b).

Lastly, counsel for the debtor argues there exists a possibility of a successful reorganization since Harry Magnuson intends to contribute additional capital. An exception to the absolute priority rule exists in the form of "infusion of new capital", commonly called the *Los Angeles Lumber* exception.[4] Simply stated, the debtor can retain an interest in the chapter 11 estate ahead of creditors to the extent new capital is put into the estate by the debtor. However, the *Los Angeles Lumber* case, and cases decided since, have developed requirements for the exception. One of the requirements, and the most demanding, is the requirement the debtor contribute capital "reasonably equivalent" to the interest retained.[5] The value is the fair market value of the property retained, valued at the time of confirmation.[6]

While it is doubtful neither the debtor, nor the members of the debtor partnership, intend to contribute capital to the extent required under the infusion of new

capital doctrine, discussion of the subject requires a determination of the value of the Mall.

In arriving at a proper value for the Bonner Mall, problems are posed by both appraisals. The debtor's appraisal of $2.4 million was based only on an income approach. The income approach does not take into consideration the occupancy potential of the Mall but considers only the poor occupancy status which presently exists. Yet the Bank's appraisal moves too far in the opposite direction, taking into consideration market value comparisons with successful malls in different localities which make comparable adjustments extremely difficult. The Bank's appraisal is further suspect in the computation of the income approach considering the basic data used and the capitalization rate used.

While the debtor is appealing the $3.2 million assessed valuation figure of the Bonner County Tax Assessor, this figure appears to be more realistic than either the debtor's or the Bank's respective valuation. Accordingly, the value of the Bonner Mall is thus found to be $3.2 million, based on the evidence presented at this hearing.

The debtor will be allowed thirty (30) days to file a chapter 11 reorganization plan and disclosure statement which is not subject to rejection as a matter of law. If no plan is filed within the thirty day period, both the Bank's motions will be granted without further hearing, under the provisions of Sections 1112(b)(1) and (2) and 362(d)(2) respectively, upon presentation of an appropriate order or orders by counsel for the Bank. If a plan is filed, its potential for confirmation may be considered by notice

and hearing, with reduced time requirements if necessary, on motion of the Bank, otherwise the Bank's motions will be denied.

It is further found the debtor has not been guilty of unreasonable delay under the provisions of Section 1112(b)(3) and no bad faith exists on the part of the debtor or the individual partners of the debtor.

The debtor's motion for use of cash collateral to require the Bank to apply $5,000.00 per month of the Yokes rentals on the $905,000.00 loan will be denied. The funds are sought to be used not by the debtor-in-possession, but are intended to be used in payment of a debt other than a debt of the debtor. While unquestionably the debtor benefitted from the series of transactions which brought the "Yoke's" store into the Mall, the funds are presently being used more appropriately as part of the Bank's adequate protection.

The contents of this decision shall constitute formal findings of fact, conclusions of law and applicable orders.

IT IS SO ORDERED.

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[1] *United Savings Assn. v. Timbers of Inwood Forest*, 484 U.S. 365, 108 S.Ct. 626, 98 L.Ed. 2d 740 (1988).

[2] *United Savings Assn. v. Timbers of Inwood Forest*, 484 U.S. at 375, 376.

[3] *In re South Village Inc.*, 25 B.R. 987 (Bankr. D. Utah 1982) and *Matter of DRW Property Co. 82*, 57 B.R. 987 (Bankr. N.D. Tex. 1986).

[4] *Case v. Los Angeles Lumber Products Co., Ltd.*, 308 U.S. 106, 60 S.Ct. 1, 84 L.Ed. 110 (1939); *In re Potter Material Service, Inc.*, 781 F.2d 99 (7th Cir. 1986); Polen and Wuhrman, the new value exception to the absolute priority rule, 93 Comm. L.J. 303; *In re Henke*, 90 B.R. 451 (Bankr.Mt. 1988); *Matter of Yasparro*, 100 B.R. 91 (Bankr. M.D. Fla. 1989).

[5] *Case v. Los Angeles Lumber Products Co.*, 308 U.S. at 122, 60 S.Ct. at 10, 84 L.Ed. at 123. *In re Potter Material Service, Inc.*, 781 F.2d at 103. *Matter of Yasparro*, 100 B.R. at 97, 98.

[6] *Matter of Yasparro*, 100 B.R. at 99.